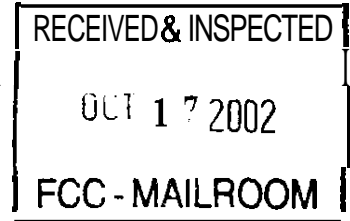


Before the
Federal Communications Commission
Washington, D.C. 20554



In the Matter of)
)
Federal-State Joint Board on)
Universal Service)

CC Docket No. 96-45

RECOMMENDED DECISION

Adopted: October 15, 2002

Released: October 16, 2002

By the Federal-State Joint Board on Universal Service: Commissioners Abemathy and Copps and Consumer Advocate Gregg issuing separate statements, Commissioners Martin and Dunleavy approving in part, dissenting in part, and issuing statements; Commissioner Rowe dissenting and issuing a statement.

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I. INTRODUCTION

1. In this Recommended Decision, the Federal-State Joint Board on Universal Service (Joint Board) provides its recommendations on issues from the *Ninth Report and Order* that were remanded to the Commission by the United States Court of Appeals for the Tenth Circuit.¹ The *Ninth Report and Order* established a federal high-cost universal service support mechanism for non-rural carriers based on forward-looking economic costs. Consistent with the court's decision, the Joint Board recommends that the Commission modify the non-rural high-cost support mechanism implemented in the *Ninth Report and Order* by adopting additional measures to induce states to ensure reasonable comparability of urban and rural rates. We also recommend that the Commission implement a supplementary rate review as a check on whether non-rural high-cost support continues to provide sufficient support to enable the states to maintain reasonably comparable rural and urban rates. In addition, we recommend continued use of statewide average costs to determine non-rural high-cost support. We believe that these recommendations will enable the Commission to satisfy the court's remand and continue to fulfill Congress's directive in the Telecommunications Act of 1996 to preserve and advance universal service.'

II. BACKGROUND

2. The 1996 Act codified the commitment of the Commission and the state regulators to promote universal service in order to help ensure that consumers in all regions of the nation have access to affordable, quality telecommunications services.² In section 254 of the Act, Congress directed the Commission, after consultation with the Joint Board, to establish specific, predictable, and sufficient support mechanisms to preserve and advance universal service.⁴ In addition, in section 254(b), Congress provided a list of principles upon which the Commission must base policies for the preservation and advancement of universal service.⁵ Among other things, section 254(b) states that consumers in rural, insular, and high-cost areas should have

¹ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432 (1999) (*Ninth Report and Order*) remanded, *Qwest Corp. v. FCC*, 258 F.3d 1191 (10th Cir.2001).

² Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act). The 1996 Act amended the Communications Act of 1934, 47 U.S.C. §§ 151, *et seq.* (Communications Act or Act). References to section 254 in this Recommended Decision refer to the universal service provisions of the 1996 Act, which are codified at 47 U.S.C. § 254 of the Act. See 47 U.S.C. § 254(b).

³ 47 U.S.C. § 254(b)

⁴ *Id.* at §§ 254(a), (b)(5), (d), (e). See also *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Notice of Proposed Rulemaking and Order Establishing Joint Board, 11 FCC Rcd 18092 (1996) (*Universal Service NPRM*).

⁵ 47 U.S.C. § 254(b)

access to telecommunications services at rates that are “reasonably comparable to rates charged for similar services in urban areas.”⁶

3. Based on recommendations from the Joint Board’ and building on the framework set forth by the Commission in prior orders,⁸ the Commission adopted the *Ninrh Report and Order* on October 21, 1999, establishing a federal high-cost universal service support mechanism for non-rural carriers based on forward-looking economic costs.’ With **the** *Ninrh Report and Order*, the Commission sought to “adopt a new specific and predictable forward-looking mechanism that will provide sufficient support to enable affordable, reasonably comparable intrastate rates for customers served by non-rural carriers.”¹⁰

⁶ *Id.* at § 254(b)(3)

⁷ See, e.g., *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Second Recommended Decision, 13 FCC Rcd 24741 (Jt. Bd. 1998) (*Second Recommended Decision*).

⁸ See, e.g., *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Repon and Order, 12 FCC Rcd 8776 (1997), as corrected by *Federal-State Joinr Buardon Universal Service*, CC Docket No. 96-45, Erratum, FCC 97-157 (rel. June 4, 1997), *aff’d in part, rev’d in parr, remanded in parr sub nom. Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999), *petition for stay granred in parr* (Sept. 28, 1999), *petitions for rehearing and rehearing en banc denied* (Sept. 28, 1999) (*First Report and Order*); *Federal-State Joint Board on Universal Service. Access Charge Reform*, Seventh Repon & Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, Fourth Repon & Order in CC Docket No. 96-262, and Further Notice of Proposed Rulemaking, 14 FCC Rcd 8077 (1999), *petition for review filed sub nom. Vermont Department of Public Service v. FCC*, No. 99-60930 (5th Cir., tiled June 23, 1999) (*Seventh Report and Order*).

⁹ *Ninrh Report and order*, 14 FCC Rcd at 20439, para. 2. Non-rural carriers are those that do not meet the following statutory definition of a rural telephone company:

The term “rural telephone company” means a local exchange carrier operating entity to the extent that such entity--

(A) provides common carrier service to any local exchange carrier study area that does not include either-

(i) any incorporated place of 10,000 inhabitants or more, or any pan thereof, based on the most recently available population statistics of the Bureau of the Census; or

(ii) any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993;

(B) provides telephone exchange service, including exchange access, to fewer than 50,000 access lines;

(C) provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines; or

(D) has less than 15% of its access lines in communities of more than 50,000 on February 8, 1996.

47 U.S.C. § 153(37). See also *First Report and Order*, 12 FCC Rcd at 8944, para. 310.

¹⁰ *Ninth Report and Order*, 14 FCC Rcd at 20451, para. 34

4. The forward-looking mechanism implemented in the *Ninth Report and Order* determines the amount of federal support to be provided to non-rural carriers in each state by comparing the statewide average cost per line for non-rural carriers, as estimated by the Commission's cost model, to a nationwide cost benchmark." The Commission adopted the Joint Board's recommendation to use costs as a proxy for rates in assessing its responsibilities to enable the reasonable comparability of rates." The Commission concluded that comparing costs in different states, rather than rates, would allow the federal mechanism to provide sufficient support to enable reasonably comparable rates without having to evaluate the myriad state policy choices that affect those rates." The Commission stated that "if federal support is available to cover costs that substantially exceed the national average, no state should face rates that are significantly higher than those elsewhere.""

5. The Commission determined that, for purposes of determining non-rural support, the statewide averaging approach was most consistent with the federal role of providing support for intrastate universal service to enable the states to ensure reasonable comparability of rates." The Commission acknowledged that states set intrastate rates and, therefore, hold the responsibility of ensuring reasonable comparability of rates within their borders? The federal mechanism operates by transferring funds among jurisdictions and has the effect of shifting money from relatively low-cost states to relatively high-cost states." No state with forward-looking costs greater than the national benchmark would be forced to keep rates reasonably comparable without the benefit of federal support.¹⁸

6. The non-rural mechanism provides support for the percentage of the costs per line allocated to the intrastate jurisdiction that exceed a national average cost benchmark of 135%.¹⁹

¹¹ The cost model estimates the forward-looking costs of providing supported services for non-rural carriers. The Commission selected input values for the model in the *Tenth Report and Order*, and found the model provides reasonably accurate cost estimates. *Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket Nos. 96-45, 97-160, Tenth Report and Order, 14 FCC Rcd 20156 (1999) (*Tenth Report and Order*), affirmed, *Qwest Corp. v FCC*, 258 F.3d 1191 (10th Cir. 2001).

¹² *Ninth Report and Order*, 14 FCC Rcd at 20441, para. 15

¹³ *Id.* at 10447, para. 25

¹⁴ *Id.*

¹⁵ *Id.* at 20457, para. 45

¹⁶ *Id.* at 20458, para. 46

¹⁷ *Id.* at 20457, para. 45

¹⁸ *Id.*

¹⁹ See *id.* at 20467, para. 63. The federal high-cost universal service support mechanism for non-rural carriers provides support for 76% of the costs that are above the national benchmark. The forward-looking mechanism calculates support based on 75% of forward-looking loop costs and 85% of forward-looking port costs, as well as 100% of all other forward-looking costs determined by the Commission's forward-looking high-cost model. Based (continued....)

The Commission concluded in the *Ninth Report and Order* that a benchmark of 135% of the national average cost balanced various goals under the statute, including sufficiency and the need to achieve rate comparability.²⁰ In addition, the Commission attempted to ensure that the fund would be no larger than necessary in order to minimize burdens on carriers and consumers contributing to universal service mechanisms.”

7. In its remand of the *Ninth Report and Order*, the court determined that the Commission did not adequately explain its decision in certain respects.²² The court observed that the Commission must base its universal service policies on the principles listed in section 254(b). In particular, the court found two principles in section 254(b) most relevant to the case: the principle that consumers in “rural, insular, and high cost areas” should have access to services “that are available at rates that are reasonably comparable to rates charged for similar services in urban areas;” and the principle that “[t]here should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.” The court also noted section 254(e), which states that any federal support for universal service “should be explicit and sufficient to achieve the purposes of this section.”

8. The court determined that the Commission did not provide an adequate explanation for its decision that the federal high-cost universal service support mechanism for non-rural carriers achieved the statutory principles codified in section 254 of the Act.²⁶ Without such an explanation, the court stated that it could not review the rationality of the *Ninth Report and Order*. The court explained: “We do not decide the underlying issue of whether the funding is in fact sufficient; rather we conclude that the FCC has not supported why the funding is sufficient.”²⁸ The court remanded the *Ninth Report and Order* to the Commission to “establish an adequate legal and factual basis for the Ninth Order and, if necessary, to reconsider the operative mechanism promulgated in that Order.”²⁹ In particular, the court concluded that the

(Continued from previous page) _____

on the percentage of forward-looking costs that the intrastate portion of each of the items represents, the Commission determined that together the items represent 16% of total forward-looking costs. *Id.*

²⁰ *Id.* at 20464, para 55

²¹ *Id.*

²² *Qwest Corp. v. FCC*, 258 F.3d at 1195

²³ 47 U.S.C. § 254(b)(3).

²⁴ *Id.* at § 254(b)(5).

²⁵ *Id.* at § 254(e).

²⁶ *Qwest*, 258 F.3d at 1202

²⁷ *Id.* at 1205.

²⁸ *Id.* at 1195.

²⁹ *Id.*

Commission did not: (1) define adequately the key statutory terms “reasonably comparable” and “sufficient”; (2) adequately explain setting the funding benchmark at 135% of the national average; (3) provide inducements for state universal service mechanisms; or (4) explain how this funding mechanism will interact with other universal service programs.”

9. On February 19, 2002, the Commission issued the *Remand Notice* seeking comment on the first three issues remanded by the Tenth Circuit and referring the record collected in the proceeding to the Joint Board for a recommended decision.” In the *Remand Notice*, the Commission reserved review of the fourth issue on remand.” The Commission stated that a response to the remanded issues relating directly to the non-rural mechanism and a critical examination of the mechanism should be completed prior to a comprehensive review of the rural and non-rural universal service support mechanisms.” As a result, the Joint Board recommendations outlined in this decision apply to the non-rural high-cost universal service support mechanism and do not address the rural mechanism.” As the Commission seeks to better coordinate and reconcile the rural and non-rural mechanisms, it may find it necessary to review or adjust the principles and procedures developed herein in response to the Tenth Circuit remand.

³⁰ *Id.* at 1201.

³¹ See *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Notice of Proposed Rulemaking and Order, 17 FCC Rcd 2999, 3010-11, paras. 25-26 (2002) (*Remand Notice*).

³² See *id.* at 3010, para. 25

³³ See *id.*

³⁴ Currently there are two separate mechanisms that provide high-cost universal service support: the forward-looking economic cost mechanism for non-rural carriers; and the modified embedded cost mechanism for rural carriers. When the Commission determined in May 1997 that universal service support should be based on forward-looking economic cost, it decided to implement such a mechanism first for non-rural carriers. See *First Report and Order*, 12 FCC Rcd at 8889, para. 203. Because rural carriers generally have higher operating and equipment costs, which are attributable to lower subscriber density, small exchanges, and a lack of economies of scale, the Commission recognized that additional effort would be needed to develop a forward-looking mechanism appropriate for rural carriers. To assist in this challenge, the Joint Board established the Rural Task Force, which was comprised of individuals representing rural telephone companies, competitive local exchange carriers, interexchange carriers, wireless providers, consumer advocates, and state and federal agencies. Rather than attempting to modify the Commission's forward-looking cost mechanism that currently is used to determine non-rural support, the Rural Task Force proposed modifications to the current embedded cost system for a five-year period. See Letter From William R. Gillis, Chair, Rural Task Force, to Magalie Roman Salas, FCC, dated September 29, 2000. In May 2001, consistent with the Joint Board's recommendation, the Commission modified its rules for providing high-cost universal service support to rural telephone companies for five years based upon the proposals made by the Rural Task Force. See *Federal-State Joint Board on Universal Service, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, Report and Order in CC Docket No. 00-256, 16 FCC Rcd 11244, 11257, para. 27 (2001) (*Rural Task Force Order*).

III. DISCUSSION

10. Based on examination of the record in this proceeding, the Joint Board recommends that the Commission modify the non-rural high-cost support mechanism implemented in the *Ninth Report and Order* by adopting additional measures that will establish specific inducements for states to ensure that rates in all regions of the nation are reasonably comparable to rates in urban areas. We also recommend that the Commission implement a supplementary rate review to assess whether non-rural high-cost support continues to provide sufficient support to enable the states to maintain reasonably comparable rates. Consistent with the court's decision, our recommendations with regard to these additional measures will support and complement the Commission's initial decision in the *Ninth Report and Order*. Specifically, we recommend a process that includes the following: (1) continuing use of a national average cost benchmark based on 135% of the national average cost; (2) funding 76% of state average costs exceeding the national benchmark; (3) establishing a national rate benchmark based on a percentage of the national average urban rate; (4) implementing state review and certification of rate comparability; and (5) providing states the opportunity to demonstrate that further federal action is needed because current federal support and state actions together are insufficient to yield reasonably comparable rates.

11. The Joint Board's recommendations comprise an integrated approach to the complex and interrelated issues referred by the Commission. We believe that these recommendations will enable the Commission to satisfy the court's remand and continue to fulfill Congress's directive to preserve and advance universal service. We note that this mechanism calculates support only for non-rural carriers. Certain assumptions in this Recommended Decision may not make sense for rural carriers. For example, as discussed below, while statewide averaging is appropriate in the non-rural mechanism, it may not be appropriate for the high-cost mechanism providing support to rural carriers."

A. Sufficiency

1. Background

12. Section 254(b)(5) of the Act provides that "[t]here should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service." Section 254(e) provides that federal support "should be explicit and sufficient to achieve the purposes of section 254[.]"³⁵ In the *Ninth Report and Order*, the Commission stated that the non-rural high-cost support mechanism would "provide sufficient support to enable reasonably comparable rates."³⁶ The Commission also stated that the level of support would be "sufficient to 'prevent

³⁵ See *infra* para. 28.

³⁶ 47 U.S.C. § 254(b)(5).

³⁷ *Id.* at § 254(e).

³⁸ *Ninth Report and Order*, 14 FCC Rcd at 10464, para. 56.

pressure from high costs and the development of competition from causing unreasonable increases in rates above current, affordable levels.”³⁹

13. The court found that the Commission did not define the key statutory term “sufficient,” but simply asserted without explanation that the mechanism it chose would be sufficient.” The court declared the rationale conclusory and, thus, “inadequate to enable appellate review of the sufficiency of the federal mechanism.”⁴¹ The court required the Commission on remand to define “sufficient” more precisely “in a way that can be reasonably related to the statutory principles, and then to assess whether the funding mechanism will be sufficient for the principle of making rural and urban rates reasonably comparable.”

14. The relationship between “sufficiency” and fund size has been addressed by the Joint Board and the Commission in other decisions. In the *Second Recommended Decision*, the Joint Board recommended a non-rural high-cost support mechanism that would enable rates to remain affordable and reasonably comparable, “but that is no larger than necessary to satisfy that statutory mandate.”⁴² The Joint Board stated that the correct fund size would be essential to ensuring that all consumers benefit from universal service. Thus, the Joint Board recognized that, in implementing a non-rural high-cost universal service mechanism, it must be mindful of two competing goals: “(1) supporting high-cost areas so that consumers there have affordable and reasonably comparable rates; and (2) maintaining a support system that does not, by its sheer size, overburden consumers across the nation.”⁴⁴ The Commission has indicated that “sufficiency” requires that universal service support not be excessive, citing the United States Court of Appeals for the Fifth Circuit’s caution that “excessive funding may itself violate the sufficiency requirements of the Act.”⁴⁵

2. Discussion

15. The Joint Board recommends that, for purposes of non-rural high-cost support, sufficiency should be principally defined as enough support to enable states to achieve reasonable comparability of rates. Sufficiency should be defined based on the relevant statutory goals under section 254(b). Thus, the definition of the term may vary depending on the underlying purpose of the universal service program in question. The principal purpose of the non-rural high-cost

³⁹ *Id.* at 20446, para. 24 (quoting *Seventh Report and order*, 14 FCC Rcd at 8092, para. 30)

⁴⁰ *Qwest Corp. v. FCC*, 258 F.3d 1191, 1201 (10th Cir. 2001).

⁴¹ *Id.* at 1201.

⁴² *Id.* at 1202.

⁴³ *Second Recommended Decision*, 13 FCC Rcd at 24746, para 3

⁴⁴ *Id.*

⁴⁵ *Rural Task Force Order*, 16 FCC Rcd at 11257, para. 27 (quoting *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 619 (5th Cir. 2000)).

support mechanism is to provide enough federal support to enable states to achieve reasonable comparability of rural and urban rates, the principle found in section 254(b)(3). As discussed in more detail below, non-rural high-cost support is designed to provide high-cost states enough support so that their net average costs are reasonably comparable to the national average cost. With reasonably comparable net costs, these high-cost states should then have the resources to ensure that rural and urban rates within their borders are reasonably comparable. The Joint Board recommends below that the Commission require states to certify that their rates are reasonably comparable or explain why they are not, and provide states the opportunity to demonstrate that further federal action is needed because current federal support and state action together are insufficient to achieve reasonably comparable rates. Accordingly, for purposes of non-rural high-cost support, the Joint Board recommends that sufficiency be defined as enough support to enable states to achieve reasonably comparable rates.

16. The Joint Board also reaffirms that the statutory principle of sufficiency means that non-rural high-cost support should be only as large as necessary to achieve its statutory goal. Correct fund size is essential to ensure that all consumers benefit from universal service.

A. Use of Costs Rather Than Rates to Determine Non-Rural High-Cost Support

1. Background

17. In the *Second Recommended Decision*, the Joint Board recommended that, because rate setting methods and goals may vary across jurisdictions, the Commission “use the *cost* of providing all supported services, rather than local rates” to determine federal high-cost support.⁴⁶ The Joint Board explained that using costs as an indicator of a state’s ability to maintain reasonable comparability of rates was appropriate because states have broad discretion to develop local rate designs.⁴⁷ State rate designs may reflect a broad array of policy choices that affect local rates, including implicit intrastate subsidies, enhanced service and other intrastate services.⁴⁸ In the *Seventh Report and Order*, the Commission adopted the Joint Board’s recommendation to use costs as a proxy for rates to perform its responsibility to enable the reasonable comparability of rates.⁴⁹

2. Discussion

18. We explain more fully here why costs rather than rates should continue to be the principal basis for determining federal support flows among states. Congress adopted section 254 to ensure that, as competition develops, there would be explicit support mechanisms in place to preserve the fundamental communications policy goal of providing universal telephone service

⁴⁶ *Second Recommended Decision*, 13 FCC Rcd at 24154, para. 19.

⁴⁷ *Id.* See 47 U.S.C. § 152(b).

⁴⁸ *Seventh Report and Order*, 14 FCC Rcd at 8092-3, para 32.

⁴⁹ See *id.* at 8092-3, paras. 52-33.

in all regions of the nation at reasonably comparable rates.” Section 254(b)(3) requires reasonably comparable rates.” This would be a relatively easy undertaking if the cost of providing telephone service were comparable in urban and rural areas. But costs are not comparable. The cost of providing telephone service is largely a function of population density and distance. Sparsely populated, rural areas have longer telephone loops, the most expensive portion of the telephone network, and fewer customers to spread the costs among. In some rural areas the cost of providing telephone service may be one hundred times greater than costs in urban areas.”

19. Although rates generally are related to costs, states may base rates on numerous considerations in addition to cost. For example, local rates may vary from state to state depending upon each state’s local rate design policies; whether or not a carrier’s rates are set based on a price cap approach; the degree to which implicit subsidies may remain within local rates; whether a state universal service fund exists; and other factors. Attempting to develop cost support levels based principally on rates would therefore likely be difficult to implement considering the lack of uniformity in local rate design practices and could lead to inequitable treatment between states with substantially similar costs but different local rate policies.

20. For these reasons, the use of costs rather than rates to determine federal support was central to the Commission’s decision adopting the non-rural high-cost support mechanism in the *Ninth Report and Order*.⁵⁰ We agree with the Commission’s past decision that cost analysis offers advantages over rate analysis for purposes of determining federal support levels. Cost analysis enables accurate comparison of states for purposes of determining federal support levels. The Commission has stated that “[a] state facing costs substantially in excess of the national average may be unable through any reasonable combination of local rate design policy choices to achieve rates reasonably comparable to those that prevail nationwide.”⁵⁴ Examining the

⁵⁰ See S. REP. NO. 23, 104th Cong., 1st Sess. 25 (1995).

⁵¹ 47 U.S.C. § 254(b)(3).

⁵² See *Federal-State Joint Board on Universal Service, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Second Report and Order and Further Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Fifteenth Report and Order, *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket 98-77, Report and Order, *Prescribing the Authorized Rate of Return from Interstate Services of Local Exchange Carriers*, CC Docket 98-166, Report and Order, 16 FCC Rcd 19613, 19635-6, para. 45 (2001) (*MAG Order*), recon. pending. This is based on comparing the forward-looking cost estimates of wire centers in the Commission’s cost model. In a case where the cost in a rural area is one hundred times greater than costs in urban areas, rural and urban rates that are within 70 to 80% may not seem unreasonable. For example, if the urban cost is \$20, the corresponding rural cost that is one hundred times greater would be approximately \$2000. An urban rate that reflects the urban cost would be approximately \$20 per line, per month. The rural rate within 70 to 80% of the urban rate is \$34-\$36, rather than \$2000.

⁵³ See *Ninth Report and Order*, 14 FCC Rcd at 20453-4, paras. 36-38. See also, e.g., Vericon telephone companies (Vericon) Comments at 8.

⁵⁴ *Seventh Report and Order*, 14 FCC Rcd at 8092-3, para. 32

underlying costs enables the Commission to “evaluate the cost levels that must be supported in each state in order to develop reasonably comparable rates.”⁵⁵

21. While the inducements to state action on rates and supplemental rate review contained in this recommendation recognize that the ultimate test of rate comparability will be the rates customers actually pay for service, the use of costs for determining the areas of greatest need establishes a firm foundation for the states to fulfill the goals of section 254 of the Act. We recommend that the Commission continue to use a cost-based approach as the principal means of achieving the statutory goal of rate comparability.

B. Use of Statewide Averaging to Reflect Appropriate Federal and State Roles in Achieving Rate Comparability

1. Background

22. The non-rural high-cost support mechanism calculates support levels for non-rural carriers by comparing the forward-looking costs of providing supported services, averaged over the statewide level, to the national benchmark. In the *Ninth Report and Order*, after consultation with the Joint Board, the Commission concluded that statewide averaging would be most consistent with the federal role of providing support for intrastate universal service to enable reasonable comparability of rates among states.⁵⁶ By averaging costs at the statewide level, the federal mechanism compares the relative costs of providing supported services in different states. It then provides support to carriers in those states with costs that exceed 135% of the national average. As the Commission explained in the *Ninth Report and Order*, “[t]his has the effect of shifting money from relatively low-cost states to relatively high-cost states. . . [and] ensures that no state with costs greater than the national benchmark will be forced to keep rates reasonably comparable without the benefit of federal support.”⁵⁷ Statewide averaging assigns to the states the primary responsibility for ensuring reasonably comparable rural rates within their borders and permits states to use their resources to achieve the goal of reasonable comparability within states.⁵⁸

23. The court stated that it did not object to the Commission’s comparison of statewide and national averages to achieve the goals of the Act.” The court also recognized that the 1996

⁵⁵ *Id.* at 8092, para. 30. The Commission has previously noted that current rates produced under the existing support regime are affordable and reasonably comparable. *See id.*

⁵⁶ *Ninth Report and Order*, 14 FCC Rcd at 20457, para. 45.

⁵⁷ *Id.*

⁵⁸ *Id.* at 20458, para 46.

⁵⁹ *Qwest Corp. v. FCC*, 258 F.3d 1191, 1202 n.9 (10th Cir. 2001)

Act “plainly contemplates a partnership between the federal and state governments to support universal service.”⁶⁰

2. Discussion

24. The Joint Board recommends that the Commission continue to determine high-cost support for non-rural companies by using statewide average costs. We believe that this reflects an appropriate division of federal and state responsibility for achieving rate comparability for non-rural companies. Because the states, not the Commission, set intrastate rates, the states have primary responsibility for ensuring reasonably comparable rural and urban rates. States tend to rely on either implicit or explicit mechanisms to transfer support from low-cost lines to high-cost lines within a state.

25. Despite implicit or explicit state **support** mechanisms, the low-cost areas of some states cannot balance their high-cost areas. Although such states could, through their own efforts, achieve reasonably comparable rates within their own boundaries, those rates would still be high relative to the national average because of the states’ high average costs. The Commission’s primary role is to identify those states that do not have the resources within their borders to support all of their high-cost lines. The non-rural high-cost support mechanism achieves this through the comparison of statewide average cost to a national cost benchmark. The averaging process provides a logical means to assess the relative extent to which states can support their high-cost areas by using resources from low-cost areas. By shifting funds to states with average costs above the national benchmark, the Commission provides federal support that is intended to enable high-cost states to set rates that are reasonably comparable to all rates across the nation.

26. The Commission explained in the *Ninth Report and Order* that the non-rural high-cost support mechanism “has the effect of shifting money from relatively low-cost states to relatively high-cost states.”⁶¹ The Commission believed that its non-rural support mechanism ensured that no state with costs greater than the national benchmark would be forced to keep rates reasonably comparable without the benefit of federal support. Statewide averaging assigns to the states the primary responsibility for ensuring reasonable comparability of rates within their borders and permits states to use their resources to achieve the goal of reasonable comparability within states.” We continue to support these policies.

27. We disagree with the contention **of** the Rural Utilities Service that high-cost customers are being hidden by statewide averaging.⁶² The Rural Utilities Service was concerned

⁶⁰ *Id.* at 1203.

⁶¹ *Ninth Report and Order*, 14 FCC Rcd at 20457, para. 45.

⁶² *Id.* at 20458, para 46.

⁶³ See Rural Utilities Service *ex parte* Comments.

about the circumstance in which some customers have high costs but the state average is not high enough to qualify for support. The use of statewide average costs reflects what we believe to be an appropriate policy decision that in such cases the state has the primary responsibility and demonstrated ability to ensure rate comparability. Federal support is needed when the state, because of its high average cost, cannot solve such a problem without imposing an undue burden on its own ratepayers.

28. While statewide averaging is appropriate in the non-rural mechanism, it may not be appropriate for the high-cost mechanism providing support to rural carriers.⁶⁴ Many rural carriers lack the economies of scale and scope of the generally larger non-rural carriers, as the Rural Task Force established in documenting differences that exist between rural and non-rural companies.⁶⁵ The Commission has stated that it intends to ask the Joint Board to conduct a comprehensive review of the high-cost support mechanisms for rural and non-rural carriers as a whole to ensure that both mechanisms function efficiently and in a coordinated fashion. Accordingly, the Joint Board does not address the complex issues surrounding high-cost support for rural telephone companies in this Recommended Decision. The Joint Board emphasizes that the current recommendation is not intended to apply to rural companies. Now that the Joint Board has concluded its recommended decision on the issues in the court's remand, we look forward to a Commission referral of a comprehensive review of the rural and non-rural high-cost support mechanisms.

C. Benchmark

1. Background

29. Before the *Ninth Report and Order*, both rural and non-rural carriers were eligible for support under the Commission's high-cost loop support mechanism, which provided increasing amounts of explicit support based on the amount by which a carrier's loop costs, as reflected in its books, exceeded the national average.⁶⁶ Beginning with loop costs between 115% and 160% of the national average, the high-cost loop support mechanism provided carriers with more than 200,000 lines support for 10% of their costs, and gradually more support as those costs exceeded 160% of the national average. Carriers with fewer than 200,000 lines were eligible for greater levels of support. Because it provides gradually more support for costs that exceed certain

⁶⁴ The Commission did not refer to the Joint Board the issue of how the non-rural high-cost support mechanism will interact with other universal service support programs, including high-cost support for rural carriers. *See Remand Notice*, 17 FCC Rcd at 3011, para. 26 n.93

⁶⁵ *See* Letter from William R. Gillis, Rural Task Force, to Magalie Roman Salas, Federal Communications Commission, dated September 29, 2000.

⁶⁶ *Ninth Report and Order*, 14 FCC Rcd at 20440, para. 13. *See* 47 C.F.R. §36.601, *et. seq.* In the *Rural Task Force Order*, the Commission determined that rural carriers would continue to receive support under the high-cost loop support mechanism, as modified pursuant to the recommendations of the Rural Task Force and the Joint Board, for a period of five years. *See Rural Task Force Order*, 16 FCC Rcd at 11246, para. 1.

thresholds, or steps, above the national average, the high-cost loop support mechanism is often referred to as a “step function benchmark.”⁶⁷

30. The current non-rural high-cost support methodology provides support for universal-service-related intrastate costs (as determined by the model) that exceed 135% of the national average cost per line for non-rural carriers. The Commission, following the Joint Board’s recommendations, developed and implemented this methodology in a series of decisions culminating with the *Ninth Report and Order*. In the *First Report and Order*, the Commission adopted the Joint Board recommendation to use forward-looking economic costs as the basis for determining support.⁶⁸ In the *Seventh Report and Order*, the Commission concluded that the new support mechanism should compare the forward-looking costs of providing supported services to a national, cost-based benchmark.⁶⁹ It also adopted the Joint Board’s recommendation that the new support mechanism “should not be significantly larger than the current explicit support mechanism.”⁷⁰ In the *Ninth Report and Order*, the Commission concluded that federal support should be provided for universal service related to all intrastate costs above the national benchmark, and that the benchmark level should be set at 135%.⁷¹

31. The Commission stated several reasons for setting the benchmark level at 135%. In the *Second Recommended Decision*, the Joint Board recommended a national benchmark in the range between 115 and 150% of the national average cost per line.” The Commission reasoned that a benchmark of 135% “falls within the range recommended by the Joint Board, and ensures that no state will face costs greater than 135% above the national average cost per line.”⁷² The Commission also reasoned that a 135% benchmark “is consistent with the precedent of the existing support mechanism and the comments we have received. The current mechanism begins providing support for costs between 115 and 160 percent of the national average cost per line, based on carriers’ books, and the vast majority of non-rural carriers receive all their current support for costs in this range. The new national benchmark of 135% is near the midpoint of this range[,]” and “a reasonable compromise of commenters’ proposals.”⁷³ The Commission further stated that “a national benchmark of 135% strikes a fair balance between the federal

⁶⁷ *Ninth Report and Order*, 14 FCC Rcd at 20466, para. 60.

⁶⁸ *First Report and Order*, 12 FCC Rcd at 8888, para. 199.

⁶⁹ *Seventh Report and Order*, 14 FCC Rcd at 8107-8, paras. 61-62.

⁷⁰ *Id.* at 8102, 8112, paras. 48 and 70. (“Given that telephone service currently is largely affordable, and any significant increase in the size of federal support for local rates appears unnecessary, we conclude that we **should** limit the size of the federal mechanism, as recommended by the Joint Board.”)

⁷¹ *Ninth Report and Order*, 14 FCC Rcd at 20438, para. 10.

⁷² *Second Recommended Decision*, 13 FCC Rcd at 24761-2, para. 43.

⁷³ *Ninth Report and Order*, 14 FCC Rcd 20463-4, para. 55.

⁷⁴ *Id.*

mechanism's responsibility to enable reasonable comparability of rates among states and the burden placed on below-benchmark states (and ratepayers) whose contributions fund the federal support mechanism."⁷⁵

32. The court found that the Commission failed to adequately explain how the benchmark of 135% would achieve the goals of the Act.⁷⁶ The court found the Commission's justifications in the *Ninth Report and Order* insufficient, stating that "[m]erely identifying some range and then picking a compromise figure is not rational decision-making."⁷⁷ The court directed the Commission to address relevant data and provide adequate record support and reasoning on remand.⁷⁸

33. Although the court rejected the Commission's justification for the benchmark, the court noted that, "if, however, the FCC's 135% benchmark actually produced urban and rural rates that were reasonably comparable ... we likely would uphold the mechanism." In addition, the court recognized that the Commission's determination of a benchmark "will necessarily be somewhat arbitrary" and acknowledged that the Commission is entitled to deference when drawing a line in the case of a reasoned decision based on the record."

2. Discussion

34. Based on examination of the record, the Joint Board continues to support the 135% benchmark. As noted above, the court appeared to consider the ability to produce reasonably comparable urban and rural rates as a key factor in supporting an appropriate cost benchmark." As the court observed, although non-rural high-cost support is distributed based on a comparison of national and statewide average costs, the benchmark must be ultimately based on attainment of the statutory principle of reasonable comparability of urban and rural rates.⁸² We have noted that the Joint Board and Commission have found in prior rulings that current rates are affordable and reasonably comparable.⁸³ These findings are supported by a recent General Accounting Office

⁷⁵ *Id.* at 20465, para. 58.

⁷⁶ *Qwest Corp. v. FCC*, 258 F.3d 1191, 1202 (10th Cir. 2001)

⁷⁷ *Id.* at 1202. The court did not address the Commission's reasoning that its choice of 135% benchmark fairly balanced state and federal responsibilities under the Act.

⁷⁸ *Id.* at 1203

⁷⁹ *Id.* at 1202

⁸⁰ *Id.*

⁸¹ See *supra* text accompanying note 79.

⁸² *Qwest*, 258 F.3d at 1202.

⁸³ See *Seventh Report and Order*, 14 FCC Rcd at 8092, para. 30

(GAO) report.⁸⁴ Based on data contained in the *GAO Report*, it appears that **six** years after passage of the Act the national averages of rural, suburban and urban rates for residential customers diverge by less than two percent.⁸⁵ We believe that the comparability of average rural and urban rates supports continued use of the 135% cost benchmark. In addition, the Joint Board finds that the current benchmark is empirically supported by a cluster analysis and a standard deviation analysis. Both of these methods indicate that the 135% benchmark targets support to states with substantially higher average costs than other states, consistent with the purpose of non-rural high-cost support.

35. Verizon argues that the 135% benchmark is consistent with Congressional intent that federal support be sufficient to maintain the range of rates existing at the time the 1996 Act was adopted.” We agree with Verizon that one of the goals of the 1996 Act was to ensure that rates remain reasonably comparable as competition develops.⁸⁷ Congress was concerned that competition would erode implicit support and adopted section 254 to preserve and advance universal service.” Verizon argues further that rates have not changed substantially since 1996, so the range of existing rates, as reflected in the *GAO Report*, should be used to determine what is reasonably comparable. Because 95% of rates fall within two standard deviations of the mean, Verizon argues that rural rates within two standard deviations of urban rates should be considered reasonably comparable.⁸⁹ Verizon points out that an analysis of the Commission’s cost model shows that two standard deviations translates approximately to a 135% cost benchmark. Thus, Verizon argues that rural rates within two standard deviations of urban rates should be considered reasonably comparable and that the cost benchmark level of 135% is

⁸⁴ United States General Accounting Office, *Telecommunications: Federal and State Universal Service Programs and Challenges to Funding* (GAO-02-187, Feb. 4, 2002) (*GAO Report*). We will address any issues concerning the General Accounting Office study later in this recommendation.

⁸⁵ See Letter from W. Scott Randolph, Director – Regulatory Affairs for Verizon communications, to Marlene H. Dortch, Federal Communications Commission, dated June 26, 2002 (Verizon June 26 *ex parte*).

⁸⁶ See Letter from W. Scott Randolph, Director – Regulatory Affairs for Verizon Communications, to Marlene H. Dortch, Federal Communications Commission, dated August 16, 2002 (Verizon August 16 *ex parte*).

⁸⁷ See Verizon August 16 *ex parte*. Verizon suggests that there is nothing in the statute to indicate that Congress believed there was an immediate problem with rate comparability because Congress did not direct the states to revise existing rate structures. *Id.*

⁸⁸ 47 U.S.C. § 254(b). Had Congress determined that rates were not reasonably comparable at the time the Act was passed, it would have directed the Commission to implement a mechanism to adjust rates immediately. Rather, Congress directed the Commission to preserve and advance universal service through the principles listed under section 254(b). While debating this issue in Congress, Senator Pressler noted that: “the need to preserve widely available and reasonably priced telephone service is one of the fundamental concerns addressed in The Telecommunications Competition and Deregulation Act of 1995.” 141 CONG. REC. S7886 (1995). Likewise, Senator Dorgan stated that Congress’s intent was to “make it clear that universal service must be maintained[.]” 141 CONG. REC. S7951 (1995), and Representative Bonilla stated that “[i]t is essential that our rural residents continue to have equal and affordable phone service.” 141 CONG. REC. H8497 (1995). See also Verizon August 16 *ex parte*.

⁸⁹ See Verizon August 16 *ex parte*.

justified because it is nearly equivalent to two standard deviations.⁹⁰ As discussed below, we agree.

36. The current benchmark is supported by a standard deviation analysis. Standard deviation is a commonly used statistical analysis that measures dispersion of data points from the mean of those data points. In a normal distribution, data points within two standard deviations of the mean will comprise approximately 95% of all data points. In other words, use of two standard deviations will identify data points that are truly outliers within the sample studied." Verizon points out that both the Commission and state commissions have adopted this statistical approach as a standard for determining parity or comparability.⁹² As applied to the cost of non-rural lines, the measurement of two standard deviations from the national average cost results in approximately 132% of the national average cost." Based on this information: the Joint Board concludes that the 135% benchmark is a reasonable dividing line separating high-cost states from the remainder of average and low-cost states.

37. The Joint Board used a cluster analysis to determine that the states receiving non-rural high-cost support under the current 135% benchmark are states that have substantially higher average costs than other states. Cluster analysis is an analytical technique that organizes information around variables so that relatively homogeneous groups, or clusters, can be identified. The Joint Board used cluster analysis to identify groups of states that had similar cost characteristics, thereby warranting different treatment regarding universal service support. Specifically, states were sorted from lowest- to highest-cost based on statewide average cost per

⁹⁰ See *id.* at 2

⁹¹ The cost data are not normally distributed, because there are more low-cost, urban lines than high-cost, rural lines. We are interested in providing support to states with more high-cost lines, so it is appropriate to use the two standard deviation measurement to identify outliers even though this measurement may identify more than expected in a normal distribution. The current non-rural high-cost support mechanism provides support to eight out of 52 jurisdictions (50 states, the District of Columbia and Puerto Rico), or 15% of the jurisdictions.

⁹² Verizon August 16 *ex parte* at Appendix A (describing the use of two standard deviations as a standard by the New York Public Service Commission in Case 97-C-0139 – Proceeding on Motion of the Commission to Review Service Quality Standards for Telephone Companies, April 29, 2002, Appendix K, Statistical Methodologies, page 1; the Pennsylvania Public Utility Commission in Joint Petition of NEXTLINK Pennsylvania, Inc., RCN Telecommunications Services of Pennsylvania, Inc., Hyperion Telecommunications, Inc., ATX Telecommunications, Focal Communications Corporation of Pennsylvania, Inc., CTSI, Inc., MCI Worldcom, eSpire Communications, and AT&T Communications of Pennsylvania, Inc., for an Order Establishing a Formal Investigation of Performance Standards, Remedies, and Operations Support Systems Testing for Bell Atlantic-Pennsylvania, Inc., Opinion and Order, P-00991643, Order Entered December 31, 1999, page 143; and the Federal Communications Commission in PA PUC Metrics Order. Attachment A-3, Calculation of Parity and Benchmark Performance, page I).

⁹³ Letter from W. Scott Randolph, Director – Regulatory Affairs for Verizon Communications, to Marlene H. Dortch, Federal Communications Commission, dated July 25, 2002 (Verizon July 25 *ex parte*). Based on the proxy model, Verizon calculated the national average at \$23.35 and the standard deviation at \$3.74. Adding the national average cost (\$23.35) and two standard deviations (\$3.74 x 2 = \$7.48), the total is \$30.83 (\$23.35 + \$7.48). \$30.83 is approximately 132% of the national average cost of \$23.35. *Id.* at 8.

loop.⁹⁴ Clusters were identified in this ranking if the difference in average costs between states was greater than “cluster split differences” ranging from 2.5 to 0.5.⁹⁵ Under this analysis, Mississippi was the first to break out into a separate cluster, and the second was the District of Columbia. The first group of states to break out into a separate rural, high-cost cluster included Kentucky, Maine, Alabama, Vermont, Montana, West Virginia and Wyoming. The remaining states, ranging from New Jersey to Nebraska, formed a separate urban, low-cost cluster. When Mississippi and the District of Columbia, the respective high- and low-cost “outliers,” were combined into the two larger clusters, “cluster stability” was achieved for a wide range of numerical values from 2.5 to 0.85.⁹⁶ “Cluster stability” means that the same clusters are maintained even as the numerical values are varied, indicating a strong similarity among members of the cluster groups. Because cluster analysis identifies a high-cost, rural cluster of states that matches the group of states currently receiving support under the non-rural high-cost support mechanism, the Joint Board finds that the cluster analysis empirically supports the current 135% benchmark.

38. Because the standard deviation analysis and the cluster analysis both support 135% as a reasonable benchmark, the Joint Board recommends continued use of the 135% benchmark. The court recognized that the use of any benchmark may be somewhat arbitrary; however, choice of a specific, percentage-based benchmark (as opposed to a mathematically calculated benchmark based on two standard deviations which may result in a different percentage each year) provides certainty to the funding process that carriers and states desire. Accordingly, the Joint Board recommends continued use of a 135% benchmark. The supplemental rate comparability review which we recommend will allow the Commission to assess how successfully the non-rural high-cost support ensures reasonable comparability of rates.

39. Some commenters suggest that, in light of the court’s decision, it would be more appropriate to use a benchmark based on average urban cost, rather than nationwide average cost.⁹⁷ The Joint Board recommends that the Commission continue to use a nationwide cost benchmark. The national benchmark is intended to ensure that each state has a relatively equal ability to achieve reasonable comparability of urban and rural rates. We do not agree that an urban **cost** benchmark would better satisfy the statutory comparison of urban and rural **rates**. Like the current mechanism, the urban benchmark substitutes costs for rates. In addition, rather

⁹⁴ Once sorted, it was then possible to identify cluster with small cost differences among the states within the cluster. Cluster analysis accomplishes this by comparing differences ~~between~~ **and** among groups, and choosing the number of groups.

⁹⁵ The numerical values used to measure the cluster split differences were 2.5, 2.0, **1.55**, 1.5, 1.0, **0.85**, and 0.5.

⁹⁶ Attached as Appendix A is a spreadsheet illustrating this analysis.

⁹⁷ See Maine Public Service Commission, Montana Public Service Commission and Vermont Public Service Commission (Rural State Commissions) Comments.

than comparing rural and urban costs, it compares statewide average costs to nationwide urban costs.⁹⁸

40. The urban benchmark proposal would require more funding or a higher benchmark level because urban average costs are lower than national average costs. For example, an urban benchmark of 165% would yield roughly the same support amounts as the current 135% national benchmark. An urban benchmark of less than 165% would require more federal support. The *GAO Report* suggests that more federal support is not necessary because urban and rural rates are similar. Proponents of the urban benchmark have not explained how additional funding produced by an urban benchmark would produce reasonably comparable rates, nor have they provided a rational justification for setting the benchmark at any particular level.

41. The urban benchmark proposal is premised in part on the argument that the current 135% national benchmark cannot enable rate comparability because it is equivalent to about 165% of urban average cost, near the 70-80% range of variability that the court doubted was reasonably comparable. As explained above, however, rates do not necessarily equate to costs, so setting a 135% national benchmark (or 165% urban benchmark) does not mean intrastate rates will vary to the same degree. For the same reason, establishing cost support based on an urban benchmark will not ensure that urban and rural rates will be reasonably comparable. Because the urban benchmark proposal does not improve the operation of the high-cost support mechanism, nor address the rate comparability concerns of the court, the Joint Board recommends that the current national benchmark be retained, supplemented by rate review to ensure comparability of urban and rural rates.

42. As discussed above, a “step function” provides gradually more support for costs that exceed certain thresholds or “steps” above the national average.⁹⁹ BellSouth supports the 135% benchmark, but proposes an additional, lower benchmark to provide some support to carriers in states with average costs between 100 and 135% of the national average cost. BellSouth proposes a step function as a means of distributing support more widely among states and, thereby, inducing states to ensure reasonable comparability of urban and rural rates. As discussed above, the purpose of non-rural high-cost support is to provide sufficient support to enable high-cost states to develop reasonably comparable rates. Providing additional support merely to induce states to ensure rate comparability without determining that additional support is necessary may conflict with the principle that support should be only as large as necessary. Nevertheless, a step function could promote predictability by preventing a total loss of federal support if small cost changes cause a state’s average cost per line to fall below the dollar amount

⁹⁸ We also note that, while discussing the use of national and statewide averages for the statutory comparison of urban and rural rates, the court rejected the “argument that the use of statewide and national averages is necessarily inconsistent with § 254.” *Qwest Corp. v. FCC*, 258 F.3d 1191, 1202 n.9 (10th Cir. 2001).

⁹⁹ See *supra* para. 29. For example, whereas the non-rural high-cost support mechanism supports all intrastate costs above the 135% national benchmark, carriers with more than 200,000 lines were formerly eligible for support for 10% of their costs between 115 and 160% of the national average and gradually more support for costs exceeding 160%. See 47 C.F.R. § 36.601 *et seq.*

of the 135% benchmark in a given year.” We believe that use of a step function may have benefits and warrants further consideration; however, the Joint Board does not recommend that the Commission add a step function to the non-rural high-cost support mechanism at this time. In light of the need to respond expeditiously to the court’s remand, the Joint Board expects to address the issue of a step function in its comprehensive review of the rural and non-rural support mechanisms.

D. Reasonable Comparability and State Inducements

1. Background

43. Section 254(b)(3) states that “[c]onsumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high-cost areas, should have access to telecommunications and information services ... at rates that are reasonably comparable to rates charged for similar services in urban areas.”¹⁰⁰ “In the *Seventh Report and Order*, the Commission adopted the Joint Board’s interpretation of “reasonably comparable” as “a fair range of urban/rural rates both within a state’s borders, and among states nationwide.”¹⁰¹ Noting that “[t]he Joint Board and the Commission have concluded that current rate levels are affordable[,]” the Commission further explained that “we interpret the goal of maintaining a ‘fair range’ of rates to mean that support levels must be sufficient to prevent pressure from high costs and the development of competition from causing unreasonable increases in rates above current, affordable levels.”¹⁰² In the *Ninth Report and Order*, the Commission also stated “reasonably comparable must mean some reasonable level above the national average forward-looking cost per line, i.e., greater than 100% of the national average.”¹⁰⁴

44. The court found the Commission’s definition of “reasonably comparable” inadequate, and required a more precise definition “that reasonably relates to the statutory principles[.]”¹⁰⁵ The court stated that the “fair range” definition

¹⁰⁰

We note that small changes in a state’s average cost per line could cause complete **loss of federal support** for certain states regardless of the level of the benchmark and regardless of whether a step function was adopted. The potential “on/off” nature of support in the high-cost support mechanism is a function of the use of a benchmark, not of the particular level of the benchmark. To the extent that a state’s average **cost** per line is at or near the **135%** benchmark, however, an additional lower benchmark would prevent the state from losing all federal support **if** its costs go below 135%.

¹⁰¹ 47 U.S.C. § 254(b)(3).

¹⁰² *Seventh Report and Order*, 14 FCC Rcd at 8092, para. 30.

¹⁰³ *Id.*

¹⁰⁴ *Ninth Report and Order*, 14 FCC Rcd at 20463, para. 54.

¹⁰⁵ *Qwest Corp.*, 258 F.3d 1191, 1202 (10th Cir. 2001).

does not help answer the questions that arise about reasonable comparability. For example, Vermont and Montana assert that some rural rates will be 70-80% higher than urban rates under the FCC's funding mechanism. We fail to see how the FCC's definition of 'reasonably comparable' illuminates this dispute. Does the FCC contend, for example, that a 70-80% discrepancy is within a 'fair range' of rates? We doubt that the statutory principle of 'reasonabl[e] comparab[ility]' can be stretched that far.¹⁰⁶

The court also stated that the Commission's further definitions were little more precise than the first and, in any event, were not reasonable interpretations of the statutory language: "The Act calls for reasonable Comparability between rural and urban rates: these definitions simply substitute different standards."''''

45. The court also required the Commission to develop mechanisms to induce state action to ensure reasonable comparability of rural and urban rates.'''In the *Ninth Report and Order*, the Commission adopted the Joint Board's recommendation that it "abstain from requiring any state action as a condition for receiving federal high-cost service support (other than state certifications)[.]'"¹⁰⁹ The Commission found it most appropriate for states to determine how non-rural high-cost support is used, "[b]ecause the support . . . is intended to enable the reasonable comparability of *intrastate* rates, and states have primary jurisdiction over intrastate rates[.]'"'' As a regulatory safeguard, the Commission required states that wish to receive non-rural high-cost support to certify annually that all such support will be used in a manner consistent with section 254(e).¹¹¹

46. The court, noting that the Act "plainly contemplates a partnership between the federal and state governments to support universal service[.]" agreed that "it is appropriate — ven necessary—for the FCC to rely on state action in this area."'''' The court found fault, however, with the Commission's reliance on states to "act on their own to preserve and advance universal

¹⁰⁶ *Id.* at 1201

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* at 1203-04

¹⁰⁹ *Ninth Reporr andorder*, 14 FCC Rcd at 20469-70, para. 67

¹¹⁰ *Id.* at 20482-3, para. 95; *see id.* at 20483, para. 96 ("As long as the uses prescribed by the state are consistent with section 254(e), we believe that the states should have the **flexibility** to decide how carriers use support provided by the federal mechanism.")

¹¹¹ *Id.* at 20483-4, para. 97; *see* 47 C.F.R. § 54.313(a) (state must certify support "will be used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended.")

¹¹² *Qwest*, 258 F.3d at 1203. The court, therefore, rejected Qwest's argument "that the Commission alone must support the full costs of universal service." *Id.*

service[.]” without inducing states to provide for rate comparability as required by the statute.”” The certification process did not meet the court’s concerns because it failed to address rate comparability.¹¹⁴ On remand, the court held that the Commission must “create some inducement—a ‘carrot’ or a ‘stick,’ for example, or simply a binding cooperative agreement with the states—for the states to assist in implementing the goals of universal service.”¹¹⁵

47. As stated above, the Joint Board and Commission determined previously that current rates generally are affordable.” and the Commission interpreted the goal of maintaining a “fair range” of rates to mean sufficient support to prevent “unreasonable increases in rates above current, affordable levels.”¹¹⁷ Some commenters contend that the *GAO Report* shows that rates remain affordable and reasonably comparable.¹¹⁸ Among other things, the General Accounting Office (**GAO**) found that there was no statistical difference in residential local telephone rates between central city, suburban, and rural places.” Other commenters contend that the GAO’s findings are not meaningful because the rates compared are not adjusted to account for the varying factors that may be included in rates in different jurisdictions.”

48. The **GAO** gathered data on basic local telephone rates from state commissions for sampled locations throughout all fifty states and the District of Columbia.¹²¹ Within each state, the GAO randomly selected places from three broad categories associated with population density: central city, suburban (other places within a metropolitan statistical area (**MSA**)), and rural (outside **MSA**). For most states, the GAO chose three places in each of the categories (and

¹¹³ *Id.* at 1203-04

¹¹⁴ *Id.* at 1203 n.10 (“It requires only that the state certify that the carrier is eligible to receive the federal funds and that the funds are being used for universal service as intended.”)

¹¹⁵ *Id.* at 1204

¹¹⁶ *Seventh Report and Order*, 14 FCC Rcd at 8092, para. 30; *First Report and Order*, 12 FCC Rcd at 8780-1, para. 2; *Second Recommended Decision*, 13 FCC Rcd at 24746, para. 3; *Federal-State Joint Board on Universal Service*, Recommended Decision, 12 FCC Rcd 87, 154, para. 133 (Jt. Bd. 1996) (*First Recommended Decision*).

¹¹⁷ *Seventh Report and Order*, 14 FCC Rcd at 8092, para. 30.

¹¹⁸ See *GAO Report*; Vericon Comments at 4-6; AT&T Reply Comments at 3-4

¹¹⁹ See *GAO Report* at 15; Vericon Comments at 4; AT&T Reply Comments at 3-4

¹²⁰ See Rural State Commissions Reply Comments at 3-4.

¹²¹ For residential and single-line business customers, the **GAO** asked for the unlimited service rate and the message or measured service rate with the lowest rate. The rates do not include the Federal Subscriber Line Charge; state and local surcharges for items such as state universal service funding, 911 service, and taxes; the federal excise tax; or long distance fees and associated universal service charges and other taxes. Where offered, the **GAO** used the tariff rate for unlimited service. Where unlimited service is not available, the **GAO** calculated a monthly fee for a “representative customer” using the message rate. The **GAO** assumed that a “representative customer” makes 100 5-minute calls per month.

four or five in larger states). The *GAO Report* provides a chart showing the average residential rate as approximately \$15.00.¹²²

49. In addition to the *GAO Report*, rate data is available from the Commission's own sources. The Commission's Wireline Competition Bureau (Bureau) has conducted an annual survey of local telephone rates in 95 urban areas for the past 15 years.¹²³ The most recent survey indicates that the average urban rate paid by residential customers for flat-rate touch-tone calling is \$21.84.¹²⁴ Unlike the *GAO Report*, the average urban rate in the Bureau's study includes federal and state subscriber line charges, and other fees which consumers must pay each month in order to receive basic telephone service.

2. Discussion

50. The Joint Board recommends that the Commission implement a procedure that will induce states to achieve reasonably comparable rates and enable the Commission to take additional action, if necessary, to achieve comparable rates. Specifically, the Joint Board recommends the Commission expand the current annual certification process under Section 254(e) of the Act to require states to certify that the basic service rates in high-cost areas served by eligible telecommunications carriers (ETCs) within the state are reasonably comparable to a national rate benchmark. For purposes of this state certification process, the Joint Board recommends that high-cost areas be defined as all wire centers with a line density less than 540 lines per square mile.¹²⁵ As part of the certification process, all states should be required to

¹²² *GAO Report* at 17. Verizon calculated the mean rates based on the **GAO** data as follows: central city, \$14.79; suburb, \$15.00; non-MSA, \$14.76. **See** Verizon June 26 *ex pane*.

¹²³ The cities surveyed are those that were included in the Bureau of Labor Statistics Consumer Price Index in the first year the survey was done.

¹²⁴ *See Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service* (Industry Analysis and Technology Div. July 2002) (*Reference Book*). The most recent survey includes data as of October 15, 2001. All 95 cities in the sample had flat-rate service available in this survey. The average rate includes a monthly charge for flat-rate service (\$14.05), federal and state subscriber line charges (65.03), additional monthly charges for touch-tone service (\$0.06), and taxes, 911 and other charges (\$2.70). The average urban rate paid by customers for message or measured service is \$15.16. Message or measured service was also available in 88 of the 95 cities surveyed. This average rate includes a monthly charge for measured/message service (\$7.27), federal and state subscriber line charges (\$5.03), additional monthly charges for touch-tone service (\$0.06), and taxes, 911 and other charges (\$2.81). In prior surveys, flat-rate service was not available in all the sampled cities, and therefore the Bureau calculated a "representative rate" for each city in order to calculate a national average rate for the 95 cities. The representative rate was the flat-rate service charge in those areas where this type of service is available. If flat-rate service was unavailable, the rate for measured/message service was used, along with the charges associated with placing 100 5-minute, same-zone, business-day calls. The average representative rate for residential local service has gone from \$17.70 in 1986 to \$21.84 in 2001. *Id.*

¹²⁵

Wire centers with fewer than 540 lines per square mile are above the national average cost, and those with more than 540 lines per square mile are below the national average cost, based on current data. In addition, the average costs of wire centers with fewer than 540 lines per square mile vary greatly. In order to assist states in making their certifications, we recommend that identification of wire centers within each state with fewer than 540 lines per square mile be provided by **USAC**. The Joint Board suggests that the Commission specifically solicit comments on (continued....)

compare basic service rates based on a standard template. The Commission should also establish a “safe harbor” whereby a state whose rates are at or below a certain rate benchmark may certify that their basic service rates in high-cost areas are reasonably comparable without the necessity of submitting rate information. However, states would have the option of submitting additional data to demonstrate that other factors affect the comparability of their rates. If a state’s rates are more than the rate benchmark, the state could request further federal action based on a showing that federal support and state actions together were not sufficient to yield reasonably comparable basic service rates statewide. Further federal actions could include, but are not limited to, additional targeted federal support, or actions to modify calling scopes or improve quality of service where state commissions have limited jurisdiction. A state requesting further federal action must show that it has already taken all actions reasonably possible and used all available state and federal resources to make basic service rates reasonably comparable, but that rates nevertheless fall above the benchmark. A state whose basic service rates exceed the rate benchmark and that requests further federal action should be required to submit rate data in support of its certification, based on a basic service rate template. The Joint Board recognizes that it may be appropriate to use 135% for the safe harbor rate benchmark, but recommends that the Commission further develop the record to establish the appropriate rate benchmark for the safe harbor.

51. The Joint Board believes that this expanded certification process meets the court requirement to induce state action to achieve rate comparability. With any support mechanism, the proof of success must be evaluated not only on whether the mechanism as a whole generally achieves rate comparability, but also upon the degree and nature of any exceptions. The court criticized the Commission for failing to adequately reconcile its conclusion that rates were generally comparable in light of instances where state rates were reportedly high.”“ Together with federal non-rural high-cost support, the expanded certification process will ensure that rates “...in all regions of the Nation...are reasonably comparable...” as set forth in section 254(b)(3).¹²⁷ The expanded certification process encourages states to scrutinize their rates using the basic service rate template, to determine whether they are reasonably comparable, and if not,

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whether a different definition of rural and high-cost areas may be more appropriate for purposes of the state rate review and Certification process.

¹²⁶

Petitioners claimed that some rural **rates** would be 70-80% higher than urban **rates** under the Commission’s non-rural support mechanism. This assertion was based on comparing **cost** data generated by the Commission’s cost model. By defining urban costs as the average cost in wire centers with 50,000 or more lines, or in the alternative, 100,000 or more lines, petitioners estimated that average rural costs are 70-80% above average urban **costs**. As noted above, when costs are not averaged, the differences between rural and urban **costs** are much greater, with costs in some rural wire centers 100 times (10,000%) above the average cost. See *supra* note 52. Neither petitioners nor any other party in the proceeding before the Commission submitted **rate** data in support of suggested benchmarks to ensure reasonably comparable rates. Because the Commission was simultaneously considering the inputs to its cost model while it was considering other aspects of the non-rural support mechanism, it urged interested parties to formulate their comments using the most recent cost model outputs available at that time. See *Ninth Report and Order*, 14 FCC Rcd at 20462-3, para. 53.

¹²⁷ 47 U.S.C.254(b)(3).

to take actions to make them reasonably comparable. When state basic service rates are at or below the rate benchmark level, then there should be a presumption that rates in that state are reasonably comparable to national urban rates. This recommended approach affords the states maximum flexibility to determine basic service rates. The Commission should accord substantial deference to these state certifications.

i. Rate Benchmark

52. **As** an initial matter, the Joint Board recommends that the Commission base the rate benchmark on the most recent average urban residential rate **as** shown in the Bureau's *Reference Book*, as modified to reflect the most recent changes in subscriber line charges (SLC).¹²⁸ The average urban rate can be adjusted annually based on data from the Bureau's annual rate survey. The Joint Board recognizes that it may be appropriate to use 135% for the safe harbor benchmark.¹²⁹ Use of a 135% rate benchmark is consistent with the national average cost benchmark of 135%.¹³⁰ The Joint Board believes that, since cost-based support is provided to ensure statewide average costs do not exceed 135% of the national average, most states should be able to maintain average rates below 135% of the national average urban rate. Based on the current national average urban rate, as adjusted, a 135% rate benchmark would be \$30.16 per line per month.¹³¹ The Joint Board recommends that the Commission further develop the record to establish the appropriate rate benchmark for the safe harbor.

53. The Joint Board emphasizes that any rate benchmark established is meant simply as a "safe harbor" for the purposes of determining rate comparability. The Joint Board does not suggest through this Recommended Decision that it is appropriate that any rates be increased to that level. The Joint Board recognizes and supports the role of state commissions in setting rates within each state. The Joint Board recommends requiring that states review only residential rate information at this time. The Joint Board suggests that it may be appropriate to solicit comment as to whether only residential or residential and business rates eventually should be reviewed by the states.

¹²⁸ *Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps, Access Charge Reform, Price Cap performance Review for Local Exchange Carriers*, Order, CC Docket Nos. 96-262 and 94-1 (rel. June 5, 2002) (approving increase in cap on subscriber line charges from \$5.00 to \$6.00 based on cost justification). The average monthly increase in the SLC's charged by non-rural companies effective July 1, 2002, was 50¢ per line. **As a** result, the average urban residential rates used in setting the rate benchmark should be adjusted upward to \$22.34.

¹²⁹ See Ohio Consumers' Counsel, Maryland Office of People's Counsel, Maine Public Advocate Office, Texas Office of Public Utility Counsel and Pennsylvania Office of Consumer Advocate Reply Comments at 5.

¹³⁰ The national average urban rate of \$21.84 per line is very close to the national average cost per line of \$21.92 produced by the Commission's cost model.

¹³¹ National average urban rate, adjusted, of \$22.34 X 1.35 = rate benchmark of \$30.16. This rate benchmark includes various charges in addition to the tariffed rate as set forth above.

ii. Basic Service Rate Template

54. The Joint Board recommends that the Commission establish a basic service rate template for states to use to compare rates. We suggest that the basic service rate template should include the items contained in the annual rate survey by the Bureau. The Joint Board recommends that the template include the following factors: the rate for a line with access to the public switched network, federal subscriber line charge, state subscriber line charge (if any), federal universal fund charge, state universal fund charge (if any), local number portability charge, telecommunications relay service charge, 911 charges,¹³² federal universal service credits (if any), state universal service credits (if any) and the federal excise tax.

iii. Expanded Rate Certification Process

55. The expanded state certification process would augment the existing state certification under section 254(e) of the Act. The existing procedure requires states to certify that all ETCs that receive federal universal service funding are using the funds to achieve the goals of the Act. The new procedure would expand reporting requirements to include a discussion of rate comparability. In the expanded certification process, states typically would report in one of four ways:

- a. Rates within the state fall below the benchmark and are considered by the state to be reasonably comparable. No further showing should be required.
- b. Rates are not below the benchmark, but may nevertheless be considered reasonably comparable. A state could show that due to other factors -- for example, additional services included in the basic service rate or the method in which the state has targeted existing universal service support -- the rates above the benchmark actually should be presumed reasonably comparable. In the alternative, the state could report on actions it intends to take to achieve reasonable comparability.
- c. Rates are below the benchmark, but are not reasonably comparable. A state may show that even though actual rates are within the safe harbor, the price paid for service received results in rates and services that are not reasonably comparable. In this case, a state could show that existing basic service is lacking in some way. For example, the state could show that the local calling area size is too small to be considered comparable service, and that toll or extended area service charges should be included to produce a reasonably comparable rate. In addition to explaining why rates within the safe harbor should not be considered reasonably comparable, the state must also show the

¹³² In states where 911 fees are not established on a statewide basis, the state **should** use a statewide average 911 fee for purposes of the standard rate template. Use of a statewide average will maintain the proper role of federal support for state, rather than local rates, and will reduce the number of separate rates in states where 911 fees are set locally.

actions it has taken or is going to take to remedy the discrepancy, prior to requesting additional federal actions to achieve reasonably comparable rates,

- d. Rates are above the benchmark and are not reasonably comparable. A state could request federal action based on a showing that current combined federal and state actions are insufficient to produce reasonably comparable rates. If the state asserts that existing federal support and state resources are not sufficient for the state to attain reasonably comparable rates, the state should be required to show that it has already taken all available steps to remedy the situation, but that rates remain above the benchmark. If the state can make this showing, the Commission would consider taking further action to meet the needs ~~of~~ the state in achieving reasonably comparable rates.”

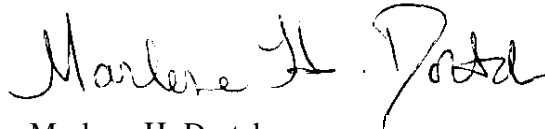
56. The Joint Board recommends that states certifying that their rates fall at or below the national rate benchmark and are reasonably comparable should not be required to submit any additional rate information. Any states requesting additional federal action should be afforded great flexibility in making their presentations, but should be required to fully explain the basis for their request. Factors that should be addressed by any such state would include, but not be limited to: rate analysis and a demonstration why the state contends that rates are not reasonably comparable; any other factors that should be considered in evaluating rates; and a demonstration that the state has taken all reasonably possible steps to develop maximum support from within the state. The requesting state should fully explain how it has used any federal support currently received to help achieve comparable rates and whether the state has implemented a state universal service fund to support rates in high-cost areas of that state. The Joint Board recommends the Commission develop exact procedures to be used in filing and processing requests for further federal actions. In particular, the Joint Board recommends that the Commission establish a time limit for consideration of such state requests, to ensure that requests will be processed and decided expeditiously.

¹³³ Existing per **line** cost support is portable to any ETC serving a customer in a high-cost wire center in a state receiving non-rural support. *See* 47 C.F.R. § 54.307. The exact amount of this high-cost support ~~is~~ available for inspection on USAC’s website and is updated quarterly.

IV. RECOMMENDING CLAUSE

57. For the reasons discussed herein, this Federal-State Joint Board pursuant to section 254(a)(1) and section 410(c) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 254(a)(1) and 410(c), recommends that the Commission adopt the proposals describe above relating to issues from the *Ninth Report and Order* that were remanded to the Commission by the United States Court of **Appeals** for the Tenth Circuit.

FEDERAL COMMUNICATIONS COMMISSION

A handwritten signature in black ink, reading "Marlene H. Dortch". The signature is written in a cursive, flowing style.

Marlene H. Dortch
Secretary